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No. 285

In the Supreme Court of the United States

OCTOBER TERM, 1933

GUY T. HELVERING, Commissioner of Internal Revenue,
Petitioner,

vs.

OTTO H. FALK, et al., Executors of the Estate of
Charles F. Pfister, Deceased.
Respondents.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

BRIEF FOR THE RESPONDENTS.

CHARLES F. FAWSETT,
RICHARD S. DOYLE,
Counsel for Respondents.

P. O. Address:
735 North Water Street,
Milwaukee, Wis.

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BRIEF FOR THE RESPONDENTS.

Statement.

All that needs to be added to the statement of facts in the brief for petitioner is that by the terms of the stip-

ulation filed at the hearing before the Board of Tax Appeals the life of the mine for the purpose of depletion allowances was nine years (R. 81).

The Question Involved.

The question involved in the case may be broadly stated as follows:

Whether in a case of a mine held in trust where the net proceeds of mining and selling the ore is distributed currently to the beneficiaries of the trust, the allowance for depletion made by the statute inures to the benefit of the beneficiaries as the taxpayers and the real parties in interest. That the mine was operated under a lease in which the trustees were the lessors and from which they received royalties as the share of the fee owner in the proceeds of the operation, does not narrow or alter the question.

It is contended by the petitioner that the entire proceeds from the working of a mine are income in the constitutional sense and may be subjected to taxation without allowance for depletion. That contention may be set aside, as the Revenue Acts beginning with the Act of 1913 have provided that in computing taxable income in the case of mines there shall be allowed a proper deduction for depletion. But it is claimed by the petitioner that in the case of a mine that is held in trust, the allowance is only to the fiduciary. In this case the fiduciaries made claim for the allowances made by the statute. It is conceded that for the calendar years 1922 to 1926, inclusive (the years here involved), the trustees made fiduciary returns in which they claimed deductions for depletion based upon a depletion rate of 13.255 cents per ton and that the Commissioner disallowed the deductions and

increased the distributive share of each beneficiary by a proportionate amount of the depletion deductions claimed, and that the amounts claimed were the proper allowances if depletion is allowable (P. Br. pp. 5, 6).

The contention of the petitioner is that under the terms of section 219 of the Revenue Acts 1921, 1924 and 1926 relating to trusts, the allowance is only to the fiduciary and must be included in the taxable income of the beneficiaries. The material provisions of that section, taken from the 1924 and 1926 Act, are as follows:

> Sec. 219 (a) The tax imposed by Parts I and II of this title shall apply to the income of estates or of any kind of property held in trust, including:
>
> (1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;
>
> (2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;
>
> * * * * *
>
> (4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.
>
> (b) * * * the tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary.
>
> The net income of the estate or trust shall be computed in the same manner and on the

same basis as provided in section 212, except that:

* * * * *

(2). There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries,

* * * * *

but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not.

Section 212 referred to as the basis for determining the *taxable income of the trust estate*, defines net (taxable) income, as "the gross income as defined in section 213 less the deductions allowed by sections 214 and 206."

One of the deductions allowed by section 214 in the case of mines is "a reasonable allowance for depletion" [214 (a) (9)].

It is not denied by the petitioner that this deduction is allowed in computing *the net income of the trust estate.* But it is contended that the benefit of the deduction is denied to the beneficiaries by *par. (2) of subdivision (b)* of section 219 which provides that, "there shall be allowed as an *additional deduction* in computing the net income of the estate or trust *the amount of the income* of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiares, * * * but the amount so allowed as a deduction shall be

included in computing the net income of the beneficiaries whether distributed to them or not."

It is the position of the respondent that such a construction of the statute is not required by is terms and is without support in reason.

Summary of Argument.

It is the manifest purpose of section 219 to impose the tax *on the net income of the trust estate* which is the gross income as defined in section 213, less the deductions specifically allowed in sections 206 and 214, one of which, in the case of mines, is a reasonable allowance for depletion. To the extent that the *taxable income* is to be accumulated and held by the trustees for future distribution, the tax is required to be paid by the fiduciary. To the extent that it is required to be distributed currently to the beneficiaries, the tax is imposed upon them and the income of the trust upon which the beneficiaries are required to pay the tax is allowed to the trustee as *an additional deduction.* This is merely a method of imposing the tax on the taxable income of the trust *directly* upon the beneficiaries to the extent that it is distributable to them currently, instead of *indirectly* by imposing it upon the trustee. In either case the tax is in reality paid by the beneficiaries, as if it were paid by the trustee it would be charged against the income currently distributable to the beneficiaries. The deductions *specifically allowed in sections 206 and 214* in determining the taxable income of the trust estate, are exempted from the tax and are not included by the terms of section 219 in the *additional deduction* allowed the trustee which is required to be included by the beneficiaries in their returns as a part of their taxable income. In the construction of the stat-

ute it is of no importance that the deductions allowed in the determination of the taxable income of the trust estate may be allowed nominally to the trustee. They are, however, allowed to the *trust estate* and not specifically to the trustee. The obvious purpose of the allowance is to exempt the amounts thereof from the tax and unless the exemptions inure to the benefit of those upon whom the tax upon the net income of the estate is really imposed, the deductions are meaningless. Where the entire net income of the trust estate computed as provided in section 212, is currently distributable to the beneficiaries, they are the taxpayers and the real parties in interest. Even if the deductions specified in sections 206 and 214 which are allowed the trust estate, were included by the literal terms of section 219 in the taxable income of the beneficiaries, they would be excluded by construction.

ARGUMENT.

I.

It is of no importance that the allowance for depletion made by the statute in the case of mines is not made specifically to beneficiaries of trusts.

Deductions allowed by section 219 in computing the net income of the trust estate are allowed to the *trust estate*, which includes the interests of the beneficiaries and the deductions must be deemed to inure to the benefit of the parties in interest, which is to say those who are called upon to pay the tax upon the income of the trust estate. If it may be considered that under the terms of the statute the deductions are nominally allowed to the trustee, this is of no importance, as the trustee is the representative of the beneficiaries of the trust.

II.

By the terms of section 219 and the sections to which it refers, the allowance for depletion applies to all cases of mines. To deny the benefit of the allowance to the beneficiaries in the case of a mine held in trust where the proceeds of its operation are distributable to the beneficiaries, is to make an exception to the application of the statute not warranted by its terms.

The contention of the petitioner would in effect deny allowance for depletion *in the case of all mines held in trust* where the net proceeds which come to the hands of the trustee are distributable currently to the beneficiaries. To allow depletion to the trustee but deny the

benefit of the allowance to the beneficiaries of the trust in such cases, would be but illusory and an idle gesture. It is the beneficiary who pays the tax. No such inanity can be read into the statute.

The construction of the statute contended for by the petitioner is not required by its terms.

1. What is to be included in computing the net income of the beneficiaries by the terms of par. (2) of subdivision (b) of section 219, is not any of the deductions that are allowed in section 214, but an "*additional deduction*" described as the amount of the *income* of the trust estate for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. The "additional deduction" cannot include anything previously allowed as a deduction. That would not be an *additional* allowance but a second allowance of something already allowed and consequently meaningless. The *amount* of the "*additional deduction*" referred to which must be included in computing the *net income* of the beneficiaries is *ex vi termini*, limited by the previous deductions to which the addition refers.

2. The additional deduction referred to is in terms *income*. It is the *amount of the income* of the trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries. The amount allowed for depletion is allowed, not *as income*, but *as a return of capital*.

U. S. vs. Ludey, 274 U. S. 295, 303.

Conceding that the entire proceeds of a mining operation may be treated by Congress as income for the purposes of the tax, Congress has not so elected in the Reve-

nue Acts, beginning with the Act of 1913. As said by this Court in *U. S. vs. Ludley*, 274 U. S. 295, 302, 303:

> "The Corporation Tax Law of 1909 (36 Stat. 112) had failed to provide for any deduction on account of the depletion of mineral reserves. *Stratton's Independence vs. Howbert*, 231 U. S. 399, 34 S. Ct. 136, 58 L. Ed. 285; *Von Baumbach vs. Sargent Land Co.*, 242 U. S. 503, 37 S. Ct. 201, 61 L. Ed. 460; *United States vs. Biwabik Mining Co.*, 247 U. S. 116, 38 S. Ct. 462, 62 L. Ed. 1017; *Goldfield Consolidated Mines Co. vs. Scott*, 247 U. S. 126, 38 S. Ct. 465, 62 L. Ed. 1022. The resulting hardship to operators of mines induced Congress to make provision in the Revenue Law of 1913 (38 Stat. 114, 167) and all later acts for some deduction on account of depletion in determining the amount of the taxable income from mines. * * * The proviso limiting the amount of the deduction for depletion to the amount of the capital invested *shows that the deduction is to be regarded as a return of capital* * * *." (Italics ours.)

And in *Bankers Pocahontas Coal Co. vs. Burnet*, 53 S. Ct. 150, 151, referring to the facts of that case the court said:

> "The applicable statutes thus construed and applied do not tax any part of petitioner's capital investment before March 1, 1913. Section 234 (a) (9) of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077, and regulations under it, require depletion allowances upon bonus and royalty payments received by the lessor of mineral lands, *sufficient to provide for a return in full of his invested capital*" (pp. 150, 151) (Italics ours).

That the allowance for depletion which has its basis in the value of the ore in place in the mine before it is mined, is in reality capital and not income, was clearly recognized by this court in *U. S. vs. Ludey*, wherein it was said:

> "The depletion charge permitted as a deduction from the gross income in determining the taxable income of mines for any year represents the reduction in the mineral contents of the reserves from which the product is taken. The reserves are recognized as wasting assets. The depletion effected by operation is likened to the using up of raw material in making the product of a manufacturing establishment. As the cost of the raw material must be deducted from the gross income before the net income can be determined, so the estimated cost of the part of the reserve used up is allowed. The fact that the reserve is hidden from sight presents difficulties in making an estimate of the amount of the deposits. The actual quantity can rarely be measured. It must be approximated. And because the quantity originally in the reserve is not actually known the percentage of the whole withdrawn in any year, and hence the appropriate depletion charge, is necessarily a rough estimate. But Congress concluded, in the light of experience, that it was better to act upon a rough estimate than to ignore the fact of depletion" (p. 302).

Reading into the statute the construction placed by this Court upon the meaning and intent of the allowance made for depletion, the amount allowed for depletion is not allowed as income, but as the element of capital in-

cluded in the proceeds of a mining operation. While the entire proceeds of a mining operation may be included in the term gross income as used in section 213, it was recognized by Congress as held by this Court that in fairness a deduction *should be allowed* for what is *in reality* not strictly income but capital, and the allowance for depletion was made as a return of capital (*U. S. vs. Ludey*, 205 U. S. 302, 303). The allowance for depletion which was claimed both by the trustees and the beneficiaries in this case, was thus given by Congress the character of capital or *part of the corpus of the trust estate* in the hands of the trustees before it was distributed to the beneficiaries. It did not lose that character by the fact of its distribution, and become income in the hands of the beneficiaries.

It is said that the beneficiaries of a trust are not allowed the benefit of deductions from income for *depreciation* of the corpus and reference is made to the statement in the opinion in *U. S. vs. Ludey* that "in essence the deduction for depletion does not differ from the deduction for depreciation." That was manifestly true for the purposes of the question involved in that case. But a distinction between the two was drawn by the court in *Lynch vs. Alworth-Stephens Co.* 267 U. S. 364, and in *Von Baumbach vs. Sargent Land Co.*, 242 U. S. 503, upon the facts of those cases. It is the established rule that statements in an opinion of the court are made with reference to the facts in the particular case and are limited thereby. We are dealing here with the question of depletion which is specially provided for in the statute, distinct from the deduction allowed for depreciation. It may be conceded that where the beneficiary under a trust is entitled only to income with no interest in the corpus, and is entitled to receive nothing that could be considered

as part of the corpus, he is not entitled to take a deduction in his income tax return for mere depreciation of the corpus in the sense in which the term depreciation is used in the statutes as held by this court in the two cases last above cited. But in the language of the Court of Appeals in *Merle-Smith, ex. Commissioner of Internal Revenue*, 42 Fed. (2d) 837, 842:

> "There is a direction in this trust to distribute to the petitioners" (here the respondents) "not only income from the mining properties but also a portion of what Congress has considered part of the capital, part of the corpus, of the trust."

By the terms of the trust instrument in this case it became the property of the beneficiaries, and if it was given the character of part of the corpus in the hands of the trustees by the Act of Congress, it cannot be supposed that it was intended by Congress to be taxable in the hands of the beneficiaries.

3. It is further contended by the petitioner that the express allowance in section 219 and other sections of the statute of certain other deductions to the beneficiaries of a trust, by implication excludes the beneficiaries from the benefit of allowances to the trust estate, not made to them specifically. The provisions referred to offer no support for that implication for the reason, among others, that they relate to *credits* or deductions not included in section 214, and which are not otherwise allowed to estates held in trust. The contention of the respondent is that a deduction allowed the trust, from income payable by the trustee to the beneficiaries of the trust who are the real parties in interest, is in reality and effect an allow-

ance to the beneficiaries even though nominally made to the trustee, except as otherwise expressly stated. It is not otherwise expressly stated as to the allowance made for depletion. It is otherwise expressly stated as to one of the deductions allowed the trustee. That is, "*the amount of the income of the estate or trust for the taxable year is to be distributed currently by the fiduciary to the beneficiaries.*" But this, as stated above, is allowed the trustee *as an additional deduction* over and above the deductions allowed in sections 206 and 214 which are allowed *all individual taxpayers* in the computation of their taxable income. Also as stated above the allowance for depletion is allowed *as a return of capital*, and is not to be considered *income* as the term is used in the additional allowance. The *additional* allowance to the trustee, is merely a method of imposing the tax on the net income of the trust estate computed as provided in section 212 *directly* upon the beneficiaries of the trust, rather than *indirectly* as would be the case if the tax upon the net income of the trust estate so computed were required to be paid by the trustee. The only difference in the result is that by imposing the tax directly upon the beneficiaries their distributive shares of the net income of the trust estate are added to their other net income and are thereby taxed at the proper rate for each according to the bracket in which the added amounts may fall.

Much reliance is placed upon *Anderson vs. Wilson*, 289 U. S. 20, as a controlling authority against the decision of the court below in this case. It seems to us there is no analogy between that case and this. That decision was based upon the construction of the will involved in the case, which as held by the Court entitled the beneficiaries only to the income from the trust estate *pending*

the time when the executors might in their discretion sell the corpus, in which case, *what was given to them was the money forthcoming from the sale and nothing more.* The question in the case appears to have been, whether on a sale of the corpus by the trustees, the beneficiaries were entitled to take a deduction in their income tax returns for the shrinkage in the value of the property sold, between the time of the execution of the will and the discretionary exercise of the power of sale which was vested in the trustee. The court held they were not for the reason that they received upon the sale of the corpus all that was given to them by the will. The allowance of depletion in the instant cases is from the proceeds of a mine which by the terms of the trust instrument, belonged to the beneficiaries of the trust. The legal question here involved is practically identical with the question involved in *Reynolds vs. Cooper* (C. C. A. 10th Cir.) decided April 3, 1933, 64 Fed. (2d) 644, now before this court for review. In the opinion of the court in that case the decision in *Anderson vs. Wilson* which was relied on there by the government as a controlling authority, as it is here, was carefully considered and held to be inapplicable (64 Fed. (2) at page 644, 646, 647).

It is further said that because section 214 makes no express provision for any allowance of the deduction on account of depletion to the beneficiaries of a trust, but does provide that the allowance made for depletion shall be equitably apportioned between lessors and lessees, this shows that it was not intended that the beneficiaries should have the benefit of the deduction for depletion allowed to the trust. That provision of the statute merely affirms by legislative enactment what was previously held by this court to be the law in *Lynch vs. Alworth-Stephens Co.,* 267 U. S. 364. The interest of the lessee

is entirely distinct from that of the lessor, whereas the trustee is the representative of the beneficiaries who are the real parties in interest. There is therefor no sort of paralll between the case of lessor and lessee and that of trustee and *cestui que trust*, and the fact that express provision was made for an equitable apportionment of the allowance for depletion between lessor and lessee, can have no bearing on the question whether the beneficiaries of a trust in the absence of any express provision of the statute to the contrary are entitled to the benefit of deductions allowed the trust where the income of the trust estate from which the allowance is made, is distributable to them.

It is contended that Section 23 (1) of the 1928 Act expressly providing for apportionment of the allowable deduction for depletion in the case of property held in trust between the income beneficiaries and the trustee, changed the pre-existing law with respect to the rights of the beneficiaries, and in support of that contention reference is made to a congressional committee report incorporated in the appendix attached to the petitioner's brief. As against that we attach hereto Confidential Committee Print No. 1, and the report of the Senate Committee on Finance, May 1, 1928, amending the House Bill and recommending its passage as amended, and quote from the report of the Finance Committee, the following:

> "The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncer-

> tainty and considerable hardship in these two classes of cases under the existing law."

In explanation of the bill in its relation to trusts it is further stated,

> "if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion."

It is apparent on the face of section 23 (l) of the 1928 Act as that section was enacted, that it does not involve any change in the pre-existing law as to the rights of the beneficiaries in the matter of depletion. The grant of the *right to depletion* is in the first part of the section and is precisely the same as in the previous acts. What is added with reference to the case of property held in trust is that the allowable deduction in such cases "shall be apportioned between the income beneficiaries and the trustees in accordance with the pertinent provisions of the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each."

It would seem clear from the wording of this provision that its purpose was to clarify and make certain the law, particularly, in cases where because of provisions in the instrument creating the trust there is need for allocation of the income from the trust estate between the beneficiaries and the trustees for the taxable year.

The terms of the statute which required that in the case of mines a reasonable allowance shall be made in determining taxable income *are all inclusive*. To except from the application of the statute all cases of mines held in trust where the proceeds of their operation are distributable currently to the beneficiaries of the trust would be to import into the statute an exception that is not authorized by its terms. As said in the *Merle-Smith* case:

> "Nothing in the statutes differentiates 1917, 1918, 1919, 1920 and 1921 nor indicates that an allowance for depletion is limited to instances where the amounts are not received by virtue of a trust, or that royalties paid under a lease of mining property are taxable in the hands of beneficiaries of a trust to a greater extent than they would be in the hands of a fee owner of the properties" (pp. 841, 842).

III.

Even if the deductions specified in sections 206 and 214 which are allowed the trust are included by the strict literal terms of section 219 in the additional deduction allowed the trustee, they must be excluded from the taxable income of the beneficiaries by construction.

The objective in the interpretation or construction of statutes, is to ascertain the meaning and purpose of the statute.

"A court is not always confined to the written word. Construction sometimes is to be exercised as well as interpretation."

U. S. vs. Farenholt, 206 U. S. 226, 229.

All laws are to be given a sensible construction; and a literal application of a statute which would lead to absurd consequences should be avoided whenever a reasonable application may be given to it consistently with the legislative purpose.

U. S. vs. Katz, 271 U. S. 354.
Re Chapman, 166 U. S. 661.
Hawaii vs. Maukichi, 190 U. S. 197.

General terms in statutes should be so limited in their application as not to lead to injustice, oppression or absurd consequences. It will always, therefore, be presumed that the legislature intended exceptions to its language which would avoid results of this character. The reason of the law in such cases should prevail over the letter.

U. S. vs. Kirby, 7 Wall. 482.
Church of the Holy Trinity vs. U. S., 143 U. S. 457.

The legislature will not be held to have done a vain and senseless thing if any other construction can legally be given to its acts.

Clark vs. Barnard, 108 U. S. 436.

The construction of section 219 contended for by the petitioner would lead to anomalous and unreasonable results and to unjust discrimination. The construction contended for by the petitioner, would except from allowance for depletion, *all cases of mines held in trust* where the net proceeds of the operation are currently distributable to the beneficiaries, whether the mine is operated by the trustees as the owners of the fee, or whether it is operated by a lessee under a lease from which the trustees receive royalties payable to the beneficiaries. Also whether or not the beneficiaries have a remainder interest in the mine itself following the termination of the trust.

In a foot note in petitioner's brief (p. 23) it is stated:

> "Since denial of the petition for a writ of certiorari in the *Merle-Smith* case, the Commissioner and the Board of Tax Appeals have both allowed deductions for depletion to the beneficiaries of trust who have a remainder interest in the corpus. *Alphin vs. Commissioner,* 21 B. T. A. 1101; *Kuhn vs. Commissioner,* 24 B. T. A. 216; G. C. M. 9804, X-2 Cumulative Bulletin 353; G. C. M. 10273, XI-1 Cumulative Bulletin 169."

There can, however, be no reason for any distinction in the case of a remainder interest if the contention of the petitioner that the allowance is made only to the fiduciary and does not inure to the benefit of the beneficiaries, is correct. To say that the deduction in the case of mines held in trust is allowed to the trustee, *means nothing* if

the deduction does not inure to the benefit of the beneficiaries who are entitled to receive the income from which the deduction is allowed to the trustee. The beneficiaries in such case are the taxpayers and the *only* parties in interest, as regards the allowance or disallowance of the deductions.

The fact that the proceeds of a mining operation are received by the taxpayer through the hands of a trustee who holds the legal title to the mine, is no reason for denying to such taxpayer the deduction for depletion which is allowed from similar income received by all other individual taxpayers. Such a discrimination would raise, at least; a serious question as to its constitutionality. It is without reason and could not be regarded otherwise than as purely arbitrary. Regardless of any constitutional question, it cannot be supposed that any such discrimination was intended by Congress.

IV.

The contention that the beneficiaries must have legal title to the ore reserve or some legal interest therein as distinct from equitable rights or a right to share in the proceeds of the exhaustion of the ore reserve is foreclosed by decisions of this court.

Palmer vs. Bender, 53 S. Ct. 225.
Lynch vs. Alworth-Stephens Co., 267 U. S. 364.
Bryan vs. Kennett, 113 U. S. 179.
Croxall vs. Sheperd, 5 Wall. 268.
Irwin vs. Gavit, 268 U. S. 161.

By the terms of the trust agreement the entire proceeds of the trust estate that come to the hands of the

trustees during the term of the trust belong to and become the property of the beneficiaries subject only to the right of the trustees to deduct expenses of administration (R. 90). The term of the trust was for two lives in being and 21 years thereafter from November 29, 1916 (R. 87). The term of the lease that remained after that date was upwards of 14 years (R. 99). For the purposes of the depletion rates allowable under the statute, the life of the mine was stipulated to be nine years (R. 99).

Upon the basis on which the depletion rates were computed the mine would be exhausted before the termination of the lease and long before the termination of the trust. There can therefore be no question in the case of a remainder interest in the ore reserves after the termination of the trust. Upon the facts stipulated, it cannot be assumed for the purposes of depletion allowances *during the term of the trust*, that there would be anything left of the ore reserves after the termination of the trust, when the life of the mine for the purposes of depletion allowances was stipulated to be only nine years and the trust extended for two lives and twenty-one years. The beneficiaries were thus not only by the terms of the trust instrument, the owners of the proceeds of the operation of the mine which came to the hands of the trustees during the term of the trust, but by the terms of the stipulation were, *ex hypothesi*, the *equitable owners* of the entire ore reserve subject to the lease.

As said by this court in *Irwin vs. Gavit*, 268 U. S. 161, 167, it was said:

> "A gift of the income of a fund ordinarily is treated by equity as creating an interest in the fund. Apart from technicalities, we can perceive

no distinction relevant to the question before us between a gift of the fund for life and a gift of the income from it."

And in *Croxall vs. Sheperd,* 5 Wall. 268, 281,

"In the consideration of a court of equity, the *cestui que trust* is actually seized of the freehold. * * * Generally, whatever is true at law of the legal estate, is true in equity of the trust estate."

In *Lynch vs. Alworth-Stephens Co.* 267 U. S. 364, 270:

"There is nothing" (in the Revenue Acts) "to suggest that the word 'property' is used in any restricted sense."

And in *Bryan vs. Kennett,* 113 U. S. 179, 192:

"The term 'property' as applied to lands, comprehends every species of title, inchoate or complete. * * * By the term 'property' applied to lands all titles are embraced, legal or equitable, perfect or imperfect."

In *Palmer vs. Bender,* 53 S. Ct. 225, 226, 227, the court said:

"That the allowance for depletion is not made dependent upon the particular legal form of the taxpayer's interest in the property to be depleted was recognized by this Court in Lynch vs. Alworth-Stephens Co., 267 U. S. 364, 45 S. Ct. 274, 69 L. Ed. 660. * * * Thus we have recently held that the lessor is entitled to a depletion allowance on bonus and royalties, although by the local law ownership of the minerals in place passed from

the lessor upon the execution of the lease. See Burnet vs. Harmel, supra; Bankers' Pocahontas Coal Company vs. Burnet, 287 U. S. ....., 53 S. Ct. 150, 77 L. Ed. ....., decided December 5, 1932" (pp. 226 and 227) (Italics ours).

The case of *Weiss vs. Weiner*, 279 U. S. 333, is relied on by the petitioner in support of the claim that the beneficiaries of a trust are not entitled to allowance for depletion. There is no analogy between that case and this. As stated in the opinion of the court, Weiner was in the business of taking long leases of property and subletting. The question involved was whether he should be allowed deduction from his income taxes for depreciation of the leased property. The court held that from the nature of the business in the course of which some of the leases were assigned and others surrendered to the lessor, it was uncertain whether he would sustain any loss from the depreciation of the leased property in a particular case, and in answer to the contention that the amount allowable for depreciation was capital and not income, the court said that the capital loss involved in the depreciation of the property was not shown to have been sustained by the lessee. The instant case is entirely different. The amount allowable for depletion is allowed as a *return* of capital and belonged to the beneficiaries of the trust in the hands of the trustees *even before it was distributed to them.* The question here is whether it was taxable as income in the hands of the beneficiaries when it was turned over to them by the trustees as required by the terms of the trust instrument. Or, regarding it as part of the gross income of the trust estate, whether its allowance as a deduction in computing the *taxable income of the trust,* does not exempt it from the

tax in the hands of the beneficiaries *as well as in the hands of the trustees.*

It is said that the beneficiaries had no investment in the trust. This is pure assumption without warrant in the record. It cannot be assumed that they did not give full value for what they received under the trust instrument. If assumption is to be indulged in, it may rather be assumed from the terms of the trust conveyance that they were the stockholders in the grantor corporation and that what they received under the trust was in lieu of their interest in the corporation as stockholders. From the fact that the depletion rates were computed on the basis of the ore reserves as of March 1, 1913 (R. 99, 100), it may be inferred that their interests related back prior to March 1, 1913, in which case the cost for income tax purposes would be the value as of March 1, 1913. By the terms of the trust instrument the conveyance of the trustees was in consideration of $1.00 and *other valuable consideration* (R. 82). This is inconsistent with any claim that the trust did not represent an investment in the trust estate, and whether the investment was by the trustees or by the beneficiaries of no importance for the purposes of the question involved. If the deduction for depletion was allowed to the trustees as a return of capital the question whether the beneficiaries had any actual investment in the corpus of the trust estate or not, can have no bearing on the question whether what was allowed to the trustees as a return of capital is taxable as income in the hands of the beneficiaries by virtue of its distribution to them as required by the terms of the trust instrument. Whatever was distributed to the beneficiaries of the trust by the trustees from what was allowed to them as a return of capital or as a part of the corpus, should not be taxable in the hands of the benefi-

ciaries regardless of whether they had any investment in the corpus of the trust or not. There is, however, no question of the amount of the investment of the beneficiaries in the corpus of the trust before the court in this case. As appears from the record, no such question was raised either before the Board of Tax Appeals or in the court below.

As said in the opinion of the Board of Tax Appeals:

> "The sole issue presented by these proceedings is whether the beneficiaries of a trust are entitled to deductions for depletion because of iron ore removed from property forming a part of the trust corpus" (R. 101, 102).

And in the opinion of the court below:

> "The amounts of the sums deducted for such purpose" (depletion) "and disallowed by the Board is not in controversy, and the sole question is whether petitioners were entitled to deduct the said items in making up their tax returns" (R. 117).

As said in *Edward Hines Yellow Pine Trustees vs. Martin*, 268 U. S. 458, 465:

> "This court is a court of review and it will not consider questions not raised or disclosed by the record brought to it for a review and which were not considered by the courts below."

It is stated in petitioner's brief (p. 5):

> "The amount of depletion to which the respondents are entitled, if such a deduction is allowable, has been stipulated and is not in dispute (R. 80, 99-100)."

All of the factors required *for the determination of the amount* of allowable depletion are impliedly included in the stipulation.

The specification of errors as stated in the petition for certiorari and repeated in the brief for petitioner filed herein, is that the Circuit Court of Appeals erred:

> "1. In holding that the respondents were entitled to a deduction for depletion of a mine constituting the corpus of a trust from which they received distributions of income.
>
> 2. In failing to hold that there is no statute authority in the Revenue Acts of 1921, 1924 and 1926 for the allowance of a deduction for depletion to beneficiaries of a trust who received distributions of trust income but have no remainder interest in the corpus of the trust."

Manifestly no question as to the amount of the investment of the beneficiaries in the trust, is raised by the above specifications, and no error of the court below could be assigned for review by this court, *with respect to a question not raised or considered in the court below.*

In conclusion it is respectfully submitted that the judgment of the court below should be affirmed.

CHARLES F. FAWSETT,
RICHARD S. DOYLE,
Counsel for Respondents.

P. O. Address:
735 North Water Street,
Milwaukee, Wis.

APPENDIX.

Confidential Committee Print No. 1

(April 27, 1928)

70TH CONGRESS
1st Session

Calendar No.

H. R. 1
(Report No. .....)

IN THE SENATE OF THE UNITED STATES

December 17, 1927

Read twice and referred to the Committee on Finance.
April ...., 1928

Reported by Mr. Smoot, with amendments

(Omit the part struck through and the part inclosed in bold-face brackets and insert the part printed in italic.)

AN ACT

To reduce and equalize taxation, provide revenue, and for other purposes.

* * * * * * *

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * * * *

(1) DEPLETION.—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each

case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In the cases of leases the deduction ~~allowed by this subsection~~ shall be equitably apportioned between the lessor and lessee. *In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the propetry and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument creating the trust, or; in the absence of such provisions, on the basis of the trust income allocable to each.* (For percentage depletion in case of oil and gas wells, see section 114(b)(3).)

Calendar No. 987

70th CONGRESS 1st Session — SENATE — REPORT No. 960

INTERNAL REVENUE BILL OF 1928

May 1, 1928.—Order to be printed

Mr. Smoot, from the Committee on Finance, submitted the following

REPORT

(to accompany H. R. 1)

The Committee on Finance, to whom was referred the bill (H. R. 1) to reduce and equalize taxation, to provide revenue, and for other purposes, having had the same under consideration, report favorably thereon, with cer-

tain amendments, and as amended recommend that the bill do pass.

* * * * * * *

SEC. 23(K) and (L). DEPRECIATION AND DEPLETION—LIFE ESTATES AND TRUSTS (p. 20)

The House bill makes no change in existing law with respect to these deductions. The committee proposes to amend and clarify the law governing the manner in which the deductions shall be apportioned as between life tenant and remainderman or trustee and beneficiary. There is uncertainty and considerable hardship, in these two classes of cases under the existing law.

In the case of life tenant and remainderman the bill provides that the deduction for depreciation shall be computed as if the life tenant were the absolute owner of the property—that is, in accordance with the estimated useful life of the property—and shall be allowed to the life tenant each year that he holds the property. In the case of property held in trust, the allowable deduction is to be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the will, deed, or other instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income which is allocable to the trustee and the beneficiaries, respectively. For example, if the trust instrument provides that the income of the trust computed without regard to depreciation shall be distributed to a named beneficiary, such beneficiary will be entitled to the depreciation allowance to the exclusion of the trustee, while if the instrument provides that the trustee in determining the distributable income shall first

make due allowance for keeping the trust corpus intact by retaining a reasonable amount of the current income for that purpose, the allowable deduction will be granted in full to the trustee. The bill contains similar provisions as to the deduction for depletion.

A clerical change is made in section 24(b) of the bill to obviate any conflict between that section and the provisions of sections 23(k) and 23(l).